Proskauer

Private Credit Deep Dives – Portability (Europe)

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One of the foundational provisions negotiated in almost every European leveraged loan agreement is the “Change of Control” definition and associated clauses. This provision is crucial because it directly impacts the risk profile of the loan from the lender’s perspective. Private credit funds and other lenders place significant importance on the identity of the sponsor when underwriting deals. Beyond the inherent credit strength of the asset in question, the sponsor’s identity and its track record in managing similar assets are equally, if not more, important considerations.

In simple terms and when triggered, the change of control provision provides lenders with an automatic exit right (where all available commitments are cancelled and all outstanding loans become immediately due and payable) or a put option pursuant to which they can demand cancellation of available commitments and repayment of all debt. For a more detailed discussion on this topic please see Private Credit Deep Dives – Change of Control (Europe) - Insights - Proskauer Rose LLP.

If change of control protection is the rule, “portability” is the exception. Portability provisions permit the debt to be “ported” and remain in place even when the borrower group is sold to a new sponsor. Although still relatively uncommon, we have seen a marked increase of portability provisions in recent months. This trend is driven by reduced M&A activity in the context of a high-interest rate environment, coupled with sustained market dislocation, where a significant gap exists between the prices sellers are willing to accept for assets and the amounts buyers are prepared to pay. As a result, sponsors are holding onto assets for longer and may need to refinance existing debt arrangements. Requests for portability are most common in these scenarios, where a sponsor typically has some visibility into a potential sale in the future and seeks to streamline deal execution and potentially lower the cost of debt-raising for buyers.

This deep dive with Daniel Hendon (Partner) and Andrew Surgey (Associate), lawyers in Proskauer's Private Credit Group in London, will highlight the benefits of and key considerations for private credit providers when negotiating and ultimately documenting portability provisions.

1. **Key benefits:**

- **Deal execution:** Portability makes it easier for a sponsor to sell an asset to a new owner without needing to renegotiate or refinance the existing loan, and without requiring the new owner to secure their own financing package. This can streamline the sale process, provide greater certainty of deal closure, and ultimately make the asset more attractive to potential buyers. This flexibility also allows sponsors to manage their portfolios more effectively without being hindered by financing constraints.
- **Cost efficiency:** Avoiding the need to refinance the loan can save both the seller and the buyer substantial costs associated with new loan origination fees, prepayment fees, legal fees, and potentially higher interest rates.
- **Continuity of financing:** The existing loan terms, including interest rates, covenants and reporting requirements remain in place, providing stability and predictability for both the borrower and the lender. This continuity can be crucial in maintaining favourable loan terms and operational consistency for management, especially if market conditions have deteriorated since the original loan was documented.

2. **Key protections** – When considering documenting portability provisions, private credit providers should aim to achieve the following key protections:

- **Sunset:** Portability provisions typically apply for a limited period post-closing. This period is generally one to two years but can extend to three years in some cases. This ensures that the portability feature is available only within a specified timeframe, mitigating long-term risk exposure.
- **Usage cap:** To prevent overuse, a limitation on the number of times the portability right can be exercised is often included. Typically, this right is allowed to be used only once over the life of the facilities. This restriction helps maintain the stability of the facilities agreement and prevents frequent changes in ownership.
- **Portability fee:** A requirement that a "portability fee", which is similar to origination/underwriting fees, becomes payable when exercised. The amount charged is deal specific, however, it is not uncommon to see a 1% fee on committed term debt. Less commonly, this fee is split between time periods (i.e., 0% due if the facilities are ported within nine months after the closing date, 0.5%

between nine months and 15 months and 1% after 15 months).

- **Approved sponsor list:** Similar to the "approved lender list" for transfers, private credit lenders may agree to an approved sponsor list. This list specifies the entities to which the lender consents for the asset to be sold. The composition of the list typically depends on the relationship the incumbent lenders have with sponsors and sponsors' track records in the market.
- **Larger deals and blanket permissions:** In larger deals, the approved sponsor list might be replaced with a blanket permission to transfer to any sponsor, provided that such sponsor meets certain criteria, such as having an agreed level of assets under management ("**AUM**"). The idea is that incumbent lenders should be comfortable with sponsors who have a certain AUM level, as this should indicate their sophistication, experience, and financial resources to support assets through both good and bad times. This approach offers more flexibility for a sponsor while ensuring that the new sponsor meets a base level requirement of assumed sophistication based on its AUM.
- **Conditions to exercise:** In order for the portability right to be exercised, lenders should consider documenting the following conditions:
- An Event of Default blocker, where the right cannot be exercised if there is an Event of Default that is continuing. This ensures that the group is in good standing and is not facing financial or other difficulties when attempting to port the debt;
- A requirement that the option is subject to a pro forma leverage test (e.g., set at opening leverage from the original deal, so the deal cannot be ported in a downside scenario where leverage has increased significantly);
- A specified minimum equity condition must be met for the portability option to be exercised. For example, there could be a requirement for a pro forma equity cushion of 50% following the new sponsor's investment. This ensures that the new sponsor has a significant equity stake, aligning their interests with those of the lenders and providing a buffer against potential financial instability; and/or
- Satisfaction of any required KYC on the incoming sponsor.
- **Call protection:** Depending on the fee structure, remaining tenor of the debt and whether a portability fee is charged, call protection may be re-set once the debt has been ported.

3. **In practice** – While documenting the portability right is straightforward in principle, it is not as plug-and-play as it initially appears because adjustments will inevitably need to be made to the finance documents to accommodate the new structure. An obvious amendment that will need to be made is to the definition of "Sponsor/Investor" to ensure appropriate change of control protection is in place.

> Another key consideration in the context of the new structure is maintaining an effective single point of enforcement without resetting hardening periods for the security. It is challenging, if not impossible, to legislate for such points, as the new structure post-porting of the debt is usually unknown at the time of documenting the portability right. Even if it were possible, the new sponsor will most likely want to make changes to the debt terms to ensure consistency across its portfolio.

In conclusion, while the prevalence of these arrangements in the European mid-market has been increasing in response to current market trends, how each arrangement is ultimately documented is inherently deal-specific. It is worth noting that, even when portability features are included, it is relatively uncommon to see them utilised in practice. When they are, portability is typically implemented through an amendment process rather than relying on the hard-wired mechanics in the facilities agreement. Although this feature obligates lenders to engage when an eligible transaction is proposed, incoming sponsors usually prefer to refinance existing facilities under new terms rather than adhere to terms negotiated by the previous sponsor. In this sense, portability is more of a gesture of goodwill from incumbent lenders and a useful marketing tool for sponsors looking to sell an asset, rather than a right that will be frequently relied upon in practice.

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